1992

Assisting a financially troubled business

American Institute of Certified Public Accountants. MAS Small Business Consulting Practices Subcommittee

AICPA

Small Business Consulting

CONSULTING SERVICES
PRACTICE AID 92-8

Assisting a Financially Troubled Business

Management Consulting Services Division

AMERICAN

INSTITUTE OF

CERTIFIED

PUBLIC

ACCOUNTANTS

NOTICE TO READERS

This practice aid will be integrated into a manual for consulting services issued by the AICPA Management Consulting Services Division and is numbered for that purpose. It is designed as educational and reference material for Institute members and others who provide *consulting services* as defined in the Statement on Standards for Consulting Services issued by the AICPA. It does not establish standards or preferred practices.

Consulting Services Practice Aids continue the series of MAS Practice Aids. The change in the numbering system of these series reflects the change of the division name from Management Advisory Services (MAS) to Management Consulting Services (MCS), rather than the discontinuing of any publications in a series.

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PREFACE

This AICPA Consulting Services practice aid is one in a series devoted to the kinds of consulting services most often provided to a CPA's small business clients. Even though the same services may also be provided to large-volume clients, experience indicates that providing advice and assistance to small, closely held businesses often involves different considerations. Small businesses frequently do not find it cost effective to have the breadth of financial and accounting expertise that is present in larger businesses. Hence, the nature and depth of the practitioner's gathering and analysis of information may differ when providing services to small and large businesses. Most important, the personal plans, finances, and desires of the small business owner may have a significant impact on the current and future operations of the business, and the practitioner must take them into consideration.

Small Business Consulting Practice Aids do not purport to include everything a practitioner needs to know or do to undertake a specific type of service. Furthermore, engagement circumstances differ, and therefore the practitioner's professional judgment may cause him or her to conclude that an approach described in a particular practice aid is inappropriate.

Although these practice aids often deal with aspects of consulting services knowledge in the context of a consulting engagement, they are also intended to be useful to practitioners who provide advice on the same subjects in the form of a consultation. Consulting services engagements and consultations are defined in the Statement on Standards for Consulting Services (SSCS) issued by the AICPA. The SSCS appears in appendix 61/A of this practice aid.

For members employed in industry and government, Small Business Consulting Practice Aids contain information that may be useful in providing internal advice and assistance to management.

CONTENTS

61/100 ASSISTING A FINANCIALLY TROUBLED BUSINESS

61/105 SCOPE OF THIS PRACTICE AID

.01 Practitioners frequently assist clients by providing services that will help their business to grow profitably. For example, they may identify areas requiring operational improvement, establish budgeting and cost controls, and obtain or restructure financing. Generally, they provide these services to a going concern whose continued operations are presumed. Sometimes, however, practitioners are engaged to assist financially troubled companies whose survival is questionable.

.02 This practice aid describes the consulting services a practitioner may provide to a financially troubled client. The practice aid's major emphasis is on fact-finding, analysis of the current situation, and consideration of alternatives for resolving the client's problems (for example, financial restructuring, downsizing of an existing entity, liquidation, term debt workout, or bankruptcy). The practice aid also discusses how the practitioner can assist in developing plans for and implementing the solution. In addition to describing approaches to all phases of such an engagement, this practice aid contains a case study with a sample engagement letter and final report, and illustrative checklists and forms.

.03 This practice aid *does not* cover those situations in which a practitioner is appointed to a management role in a financially troubled company.

61/110 TYPICAL ENGAGEMENT SITUATIONS

.01 An engagement to assist a financially troubled business may arise from such circumstances as the following:

- The practitioner discovers the client's financial difficulty while providing other services and recommends a consulting engagement.
- The client recognizes that its problems with creditors are serious and asks a CPA for assistance. The financial problems may be just beginning or may be longstanding.
- The client's attorney or creditor recommends that it seek the financial expertise of a CPA.

.02 The causes of financial problems that warn of future collapse can usually be detected years ahead of the accounting events that signify failure. The first signs of failure are often managerial, not financial, problems. In fact, the Turnaround Management Association attributes between 70 and 75 percent of business failures to poor management, citing the following situations as typical:

- Boards of failed companies often have had an inappropriate mix of skills for a long time before the firm began to falter (for example, too many engineers and too few people with financial expertise).

- Too many decisions are made by one person without active participation by others.

.03 Other causes include obsolete inventories and production facilities, and employee-management conflicts leading to high turnover.

.04 Failing companies often lack or are deficient in systems or information needed to support operations. These include:

- Systems for planning or accounting information suitable to support corporate planning

- A budget system to inform management of actual performance against budget

- A cash flow plan that supports planning for periods of peak cash needs

- A costing system with adequate information on the amount of profit generated from each unit of production

.05 Other key causes of financial problems are overtrading, high leverage, or the launching of too large a project. Overtrading may cause sales to increase faster than the company can collect, thereby depleting cash. High leverage can bring financial misfortune when such events as an unexpected sales decline or a cost overrun occur.

.06 Each or a combination of these factors can endanger a company's financial security.

61/115 ENGAGEMENT ACCEPTANCE CONSIDERATIONS

.01 Greater risks are involved in an engagement to assist a financially troubled client than in most other engagements. The risks are associated with business and emotional issues that the practitioner does not normally encounter. Consequently, the practitioner needs to be especially careful when deciding whether to accept the engagement. To determine whether the CPA firm is interested in and is capable of conducting the engagement, the practitioner assesses the risks of litigation against the firm or practitioner, the consistency of the engagement with the firm's policies and goals, and the coverage provided by its liability insurance for performing the service. The practitioner also considers whether the firm has or can obtain the technical and industry expertise needed to provide the service. Exhibit 61B-1 in appendix 61/B provides a sample checklist of questions regarding CPA firm issues that the practitioner needs to consider.

.02 Client acceptability is also an extremely important consideration in deciding whether to accept the engagement. To determine acceptability, the practitioner assesses the honesty, integrity, and competence of the owners and management, their reputation in the community, their ability to take criticism, and the company's ability to pay for the practitioner's service. Answers to the questions in the Engagement Acceptance Checklist—Client Considerations provided in exhibit 61B-2 will help the practitioner determine client acceptability.

.03 The practitioner needs to consider obtaining a retainer before providing any services and should monitor engagement time and costs very carefully. This is because, if the company files for bankruptcy, services rendered prior to the filing will become unsecured claims against the estate. Before accepting the engagement, the practitioner also meets with the client's attorney to discuss the client's legal situation.

.04 Appendix 61/B includes additional forms that the practitioner can use to reach a decision about accepting the engagement.

61/120 CLIENT BENEFITS

.01 An engagement to assist a financially troubled company may benefit the client in the following ways:

- Restoration of financial stability
- Minimization of asset loss
- Provision of an opportunity for client management to direct its attention to long-term strategy rather than mere survival
- Improvement in creditors' confidence in the client
- Implementation of financial controls to prevent the recurrence of problems
- Development of strategies for debt renegotiation
- Development of a business plan

61/125 UNDERSTANDING WITH THE CLIENT

.01 The practitioner may wish to conduct a preliminary survey to gain information that will help to develop the appropriate objectives and scope for the engagement and to determine a suitable fee. The practitioner needs to reach an understanding about these matters with the client before outlining them in an engagement letter.

Conducting a Preliminary Survey

.02 In some instances, the practitioner may need information to develop the understanding with the client or to submit a proposal explaining the services to be provided, the approach to be taken, and the associated costs. A preliminary survey can provide such information. Possible goals of performing a preliminary survey include:

- To identify major problems, including operational problems, and their causes
- To determine the financial condition of the company
- To differentiate between problems that need immediate attention if the company is to survive and problems that must be addressed in the long term to rebuild the company
- To recognize the long-term prospects of the company

.03 The basic information gathered during the preliminary survey provides an overview of the client's situation and supports a preliminary assessment of the root cause of the financial problems. To make this assessment, the practitioner needs to review the following information:

- Financial records, including financial statements, balance sheets, tax returns, vendor and customer contracts, budgets, and other pertinent business information (see exhibits 61B-3 and 61B-4)
- External-influence information, such as local economic data, industry data and trends, government regulations, as well as information about the client's competitors
- Management-control and decision-making information concerning operations, capitalizations, product pricing, and marketing
- Management assessment of key personnel's experience, educational background, and overall ability to implement changes that may be required (see exhibit 61B-5)

.04 Less time is needed for a preliminary survey of an existing client because the practitioner is familiar with its operations, personnel, and other key elements.

Engagement Letter

.05 After the practitioner and client agree to an engagement, they reach an understanding about its objectives, scope, and conduct. The practitioner prepares an engagement letter describing the services to be rendered, the manner in which they will be performed, and the estimated fee and expenses. At the outset, the practitioner explains that positive results are not guaranteed and that the engagement fee does not depend upon the outcome of the analysis or the recommended plan of action. Given the client's financial weakness, the practitioner may wish to request a retainer and to reserve the right to withdraw from the engagement at any time. This reservation will be important if the practitioner discovers that the client has acted unethically or in bad faith.

.06 In the engagement letter, the practitioner may also wish to—

- Describe the request for the engagement.
- Identify the client's financial problems.

- Cite the potential benefits of the engagement.
- Describe each phase of the engagement, including how the client will receive feedback on the engagement's progress and conclusion.
- State the client's responsibilities.
- Detail the conditions under which the practitioner can discuss aspects of the company with creditors.
- Identify the personnel assigned to the engagement.
- Identify management's liaison for the engagement, if any.
- Explain how the fee was derived, including the manner of billing and the payment terms.

.07 If the scope of an engagement changes after it has begun, the practitioner sends the client a revised engagement letter that states the new scope and terms. Exhibit 61C-1 in appendix 61/C provides a sample engagement letter.

61/130 ENGAGEMENT SCOPE

.01 Typically, an engagement to assist a financially troubled company consists of evaluating the client's situation, analyzing the options available, recommending a plan of action, and in some situations, assisting in implementing the plan. Although each situation will differ, the engagement approach generally is the same.

.02 In addition to analyzing the situation and recommending solutions, the practitioner may be requested to assist in preparing cash flow statements and financial projections, developing a long-range strategic plan for reorganization, implementing and monitoring the plan, and developing negotiation strategies for the company to use to restructure its debt.

.03 The practitioner may encounter conditions that differ, however, from other consulting engagements. For example, creditors may be hostile, and client management may be too distraught to carry out its normal responsibilities. Despite such conditions, the client will need to attempt to make timely decisions.

.04 When the circumstances indicate that liquidation of the company's assets is the best solution, the practitioner will need to assist the client in developing a liquidation plan. Part of the plan might include forecasted liquidation balance sheets and appraisals.

.05 Most engagements will involve evaluating critical tax issues. The practitioner therefore needs to be familiar with the federal and state tax implications of liquidation and bankruptcy or to consult with knowledgeable professionals about them. In cases when the company is considering seeking court protection under Chapter 11, the practitioner must be aware of the local bankruptcy guidelines and work with bankruptcy counsel to ensure that the company (debtor) files the appropriate documents in a timely manner. Such documents can include information about the financial condition of the company as of the date of filing bankruptcy and bi-weekly or monthly financial information subsequent to filing.

61/135 PRACTITIONER'S ROLE

.01 Practitioners assisting financially distressed clients are often subject to strains they do not experience during engagements for financially secure clients. For example, practitioners will often become exposed to pressures induced by cash flow shortages, demands from bankers and creditors for payment, and short time periods to produce information, along with other pressures brought on by taking a more active role with management. To deal with these pressures successfully, practitioners ensure that their role of providing objective analysis of the client's situation and recommending a course of action is clearly understood by client management. Practitioners should not assume a management role if the client appears shell-shocked by financial and other company problems, and they should avoid management acts such as signing checks and corporate documents. Decision making is solely the client's responsibility.[1] Failure to maintain a strict advisory role may expose practitioners to legal liability if the client or its creditors are dissatisfied with future client performance.

.02 In the event the practitioner provides attest services for the client, professional standards allow only an advisory role during an engagement. Professional standards do allow performance of management duties in an engagement of this type, but a conflict of independence in the attest function must be avoided if that relationship exists.

.03 Practitioners also need to avoid advising on legal matters, especially during engagements in which a reorganization or bankruptcy is the recommended action. These matters are subject to complex law and regulations, and advice on them is often hard to separate from financial advice. The best approach is for the practitioner to work closely or confer continually with the client's attorney or with other attorneys who specialize in financial law. Only an attorney should provide legal advice.

61/140 ENGAGEMENT APPROACH

Fact-finding

.01 During the fact-finding phase of the engagement, practitioners build on the information obtained in the preliminary survey. Often, practitioners need to complete this phase very quickly because the client requires urgent assistance. Through interviews with the client's personnel and attorney, and review of company documents and data (for the last three to five years), practitioners can learn additional facts about internal and external influences on the company's situation.

[1] A practitioner may be engaged to function in a client management role, but such services are not the subject of this practice aid.

.02 The additional financial information obtained includes unrecorded assets, such as patents and leases, the amounts of uninsured casualty losses, misappropriated funds, if any, and write-offs. Additional industry information includes the company's life-cycle position compared with industry patterns, standard ratios, and performance benchmarks. Practitioners can get much of the industry information from trade organizations and standard reference services, such as Dun and Bradstreet, Robert Morris Associates, and Standard and Poor's.

.03 To advise management appropriately, the practitioner needs a full understanding of the company. By reviewing the following information, the practitioner can adequately assess the condition and status of the company to provide proper recommendations. Depending on its adequacy and availability, this information will sometimes need to be created.

.04 *Management and organization information*

- The chart of organization
- Employee staffing levels
- Management compensation
- Employee compensation
- Labor contracts

.05 *Sales information*

- Annual gross sales by major customers
- Sales and gross profit by product line
- Current aged receivables
- Monthly sales data
- A list of former major customers

.06 *Purchasing information*

- Annual purchases by supplier
- Current payables
- Monthly purchase order data

.07 *Production cycle information*

- Job cost reports by product line

- Production reports by product line
- Inventory and materials shrinkage

.08 *Legal information*

- Financial judgments
- Regulatory requirements and citations for violations
- Pending legal action
- Warranty and contractual obligations

.09 *Debt obligations*

- Leases
- Debt instruments

.10 To facilitate the fact-finding phase, practitioners may wish to use a diagnostic process. Diagnostic techniques for identifying and resolving client problems are presented in Small Business Consulting Practice Aids No. 2, *Identifying Client Problems: A Diagnostic Review Technique* (New York: AICPA, 1983) and No. 3, *Assisting Clients in Maximizing Profits: A Diagnostic Approach* (New York: AICPA, 1984). The valuable information in these practice aids is also available on diskette: *Small Business Consulting Tool: Diagnostic Review Checklists for Maximizing Profits* (New York: AICPA, 1992).

Evaluating the Client's Situation

.11 After completing the fact-finding phase of the engagement, the practitioner reviews and evaluates the client's circumstances in order to recommend an appropriate course of action. During this phase, the practitioner analyzes the following elements of the client's financial condition.

.12 *Major costs.* The practitioner analyzes a list of company expenses ranked in order of amount and categorized as direct, indirect, or administrative to identify costs that are unusually high.

.13 *Inventory and profit margins.* The practitioner evaluates the profit margins of each product or service to determine whether to recommend that less profitable products or services be discontinued. Inventories should be aged by product line and reviewed for net realizable value, particularly obsolescent and slow-moving items.

.14 *Cash flow forecasts.* The practitioner prepares or revises financial forecasts for thirty, sixty, and ninety days and for the next six-, nine-, and twelve-month periods. In some engagements, the cash flow forecast may need to be even more short-term, perhaps weekly.

.15 *Industry trends.* The client's financial problems may be characteristic of a declining industry or unique to the client. In the case of an industry-wide decline in demand for the product or service, the practitioner usually encourages the sale, liquidation, or downsizing of the business.

.16 *Accounts payable and credit analysis.* The practitioner reviews all credit arrangements with suppliers and lenders and ages and analyzes accounts payable. The practitioner ranks creditors according to their immediate need for payment and their likelihood of pursuing litigation to collect. In addition, the practitioner carefully considers whether the payables can be satisfied through the sale of nonessential assets or secured asset loans.

.17 *Receivables.* The practitioner ages receivables and evaluates credit and collection policies and activities.

.18 In analyzing these elements of the client's financial situation, the practitioner usually finds that the problems are caused, at least in part, by such factors as—

- Inefficient operations.
- A lack of certain management skills.
- Failure to monitor the competitive environment.
- Ineffective marketing.
- Inappropriate credit policies and activities for both receivables and payables.
- Undercapitalization.
- Excessively rapid growth.
- Weak financial controls, such as inappropriate pricing, poor budgeting procedures, or inadequate cost accounting.
- Crisis management instead of long-term planning.

Developing Recommendations

.19 During the fact-finding and evaluation phases, the practitioner may detect certain critical problems, which usually provide the basis for recommendations. To facilitate the analysis and recommendation process, the practitioner may find it helpful to assemble information in a matrix, such as that illustrated in figure 61-1.

Figure 61-1
Illustrative Client Problem Matrix

Cause	*Effect*	*Recommendations*	*Priority*
Death of a key person	Deteriorating customer relations	Promote assistant Hire replacement	B
Cash shortage	Inability to purchase goods	Negotiate with supplier to deliver on partial payment	A
	Inability to meet payroll	Factor receivables Sell assets	
Hostile creditor	Inability to acquire goods	Find alternative sources	A
	Pending judgment	Seek Chapter 11 protection	
Loss of a major customer	Rapid decline in sales	Assess alternative product or uses of idle facility	B
Undercapitalization	Inability to borrow	Sell stock to third parties Encourage owner to contribute additional capital	B
Obsolete plant	Slow production due to out-of-date technology	Modernize equipment Consider contracting outside, possibly with a foreign producer	C

Priority key:

A - Urgent
B - Needs attention
C - Set for later consideration

.20 At this point, it is generally apparent whether the company can continue to operate for at least a short period or whether it must be liquidated. The experienced practitioner will be in a position to consider recommending a solution such as a refinancing, a workout with creditors, liquidation, Chapter 11 proceedings, or some other action. Whatever the outcome, the practitioner can provide a valuable service by assisting in developing and implementing a plan of action. At this point, it is also appropriate for the practitioner to modify the agreement with the client to include these services.

.21 **Strategies for Continuing Operations.** If continuing operations is determined to be feasible, the practitioner considers recommending the following strategies and eventually may include them in the plan of action. In selecting strategies, the practitioner keeps in mind that restructuring of a closely held family business requires tact and consideration. It is important to use techniques that allow the owners to save face, because they will continue in management of the company.

.22 *Management strategies*. General management strategies may include deferring maintenance and allocating resources among divisions and departments to support profitable lines and eliminate marginal lines. The practitioner should also evaluate the need to add management team members to offset weaknesses identified in the current management team. Another strategy is to select a turnaround expert, who, as an objective party, can make difficult management decisions more easily than the owners of the closely held business.

.23 *Financial strategies*. Financial strategies will vary according to the client's viability, which may depend on the value of its real estate assets or its product line compared with its outstanding obligations. The practitioner considers drawing on venture capital sources as well as selling stock or part of the business. However, a troubled business is unlikely to obtain venture capital, sell stock, or otherwise raise funds unless the product or service is highly desirable and a plan can be developed for the future. In some situations, an employee stock purchase may be feasible.

.24 Often the troubled business can work out agreements with existing creditors who usually tighten the credit terms. However, the client can attempt to negotiate favorable credit terms and delay payment to creditors for forty-five to ninety days. Selling or using receivables as collateral can ease short-term cash deficiencies, although conventional bank financing is a preferable and less expensive option.

.25 Late or nonpayment of payroll taxes is a common situation in troubled companies. Large penalties and interest charges may result. In extreme cases, levies on bank accounts and liens on property may be made, or legal action may even be taken against owners and officers. To avoid these problems, the client needs to deposit payroll taxes at the time the payroll is prepared.

.26 Nonessential expenses, such as fringe benefits, may be suspended or reduced. Idle property may be sold or leased. The client can also consider purchasing such services as janitorial services and sales representation rather than using employees. Leases may be renegotiated and leased property returned. Equipment costs can be lowered by renting or leasing replacements. The practitioner also reviews governmental programs for possible assistance.

.27 *Production strategies.* The practitioner needs to evaluate staffing at all levels. If personnel can be cut back in production areas, fewer administrative or support personnel may also be necessary. In some cases, paying overtime or using temporary help for a short period may be preferable to adding full-time permanent employees. Supply contracts may need to be restructured to provide for delayed delivery and extended terms. The client must consider putting on hold any plans to expand plant or equipment. If contracts have already been signed, delay or cancellation of the expansion needs to be negotiated with the contracting company.

.28 *Marketing strategies.* Inventory on hand needs to be analyzed, and sales efforts need to be reviewed and promotions considered for slow-moving products. The client can consider offering the sales force incentives to sell selected items above specific sales goals. The practitioner carefully reviews the gross margin of each product line and cost center. In some cases, product prices may need to be increased to improve profitability, or products may need to be discontinued. A price increase may be viable if the product is not price sensitive and has a steady market. Another strategy is to evaluate potential new markets and services that will add to gross sales without requiring large capital outlays. The practitioner who lacks marketing skills also needs to talk to the client about engaging a marketing consultant.

.29 *Chapter 11.* Seeking court protection under Chapter 11 of the bankruptcy code is a possible course of action. The feasibility of this alternative requires careful evaluation, and, if chosen, it requires complex planning. The purpose of Chapter 11 is to rehabilitate the business. The filing for protection allows the company time to develop a plan of reorganization so that it can pay its creditors. Most often, the debtor remains in possession, operates the business, and develops the reorganization plan. If, however, the bankruptcy judge and creditors suspect fraud, dishonesty, or incompetence on the part of the company management, an independent trustee is appointed to run operations. The debtor has the exclusive right to file with the court within 120 days a plan to reorganize the business and satisfy creditors' claims. The debtor then has an additional sixty days to get the plan accepted by the creditors. If the plan is not filed on time or is unacceptable, other parties of interest may file a proposed plan.

.30 The process of seeking protection is expensive because it requires a great deal of planning and the services of attorneys and certified public accountants. The reorganization also requires an inordinate amount of management's time, which may be unavailable in a small company. If a satisfactory plan of reorganization cannot be established, the company reverts to Chapter 7, which provides for the liquidation of a company in order to satisfy the creditors' claims.

.31 The practitioner can be engaged by the debtor in possession or the trustee to provide information to the court and creditors' committee. The information could include—

- A cash flow statement.
- A classified balance sheet.
- A break-even analysis.
- A classification of creditors' claims.
- Operating statements.

.32 To ensure the highest priority for payment of services, the practitioner needs to be appointed by the court before beginning work for a client who has filed under the bankruptcy code. To realistically approach an engagement to provide services involving Chapter 11, the practitioner needs to be aware of the statistics on the survival of companies seeking this protection. According to the Turnaround Management Association, less than 30 percent of companies with sales under $25 million, and less than 69 percent of those with sales over $100 million, carry out an effective plan and remain in business under the same ownership.

.33 *Other strategies.* The practitioner considers renegotiating labor contracts. The renegotiated contracts can reduce costs for the short term in exchange for long-term escalation clauses. Meetings with employees to request their assistance by accepting salary reductions or cutbacks in hours may be helpful.

.34 **Liquidation.** When the company is too burdened to pay off its debt in a reasonable period and has little equity or goodwill, the best course of action may be to discontinue operations. The client can either arrange an informal liquidation with the creditors or file for bankruptcy under Chapter 7. In either case, the client needs to consult legal counsel before making a decision.

.35 If the liquidation is informal, the practitioner and client should follow the procedures of a formal liquidation under Chapter 7 as closely as possible. Such an approach will improve the chances for a successful informal liquidation and facilitate the transition to a Chapter 7 proceeding, if required.

.36 An informal liquidation requires meeting with creditors to outline the company's financial condition. Assets are reported at estimated net realizable values, and liabilities are categorized as secured or unsecured. The creditors require a plan that projects the amount and timing of payments to them. If any creditor rejects the informal arrangement, the client needs to secure protection from the bankruptcy court.

.37 The practitioner can assist the company in evaluating the alternatives available for disposing of assets. In doing this, the practitioner will find helpful guidance in MAS Technical Consulting Practice Aid No. 8, *Mergers, Acquisitions, and Sales* (New York: AICPA, 1986), and in MAS Small Business Consulting Practice Aid No. 8, *Valuation of a Closely Held Business* (New York: AICPA, 1987). The practitioner may wish to arrange a separate engagement for a valuation of the company. If real estate is to be valuated, a qualified real estate appraiser will be needed, and if substantial equipment is involved, a qualified equipment appraiser. The practitioner will also find guidance in two AICPA Continuing Professional Education self-study programs, *Bankruptcy I* and *Providing Services to Start-Up and Financially Troubled Businesses* (the latter is also presented as a one-day seminar).

.38 Sale of all or part of the company as a going concern may yield the largest return, but it must take place while the company still has its customers and key employees. A company under the protection of Chapter 11 is attractive to some investors because liabilities are determinable and, if unsecured, are generally discounted. If no suitable buyer can be found, the practitioner evaluates other methods of disposal of the assets. The client's competitors may wish to buy customer lists and equipment. If a sale of assets cannot be arranged, an auction may be the last resort.

61/145 ENGAGEMENT MARKETING

.01 Practitioners have various opportunities to market their expertise in assisting financially troubled businesses. They can cultivate other service professionals, such as bankers, attorneys, and insurance agents, as referral sources. One way to cultivate these professionals is to conduct seminars on how members of each of these professions can identify a troubled business at an early stage. Another seminar topic is how these professionals can interface to assist the troubled client.

.02 Practitioners can also market their services through contacts with attorneys who specialize in bankruptcy law. In discussions, they can brief these attorneys on the support staff available to practitioners, the basic approach used to assist troubled businesses, and the fees involved.

.03 The most promising market sources may be the practitioners' own clients. Practitioners can find leads to prospects by carefully reviewing client files and using financial models that predict problems to monitor the monthly financial statements of borderline clients. Referrals by clients whom practitioners have assisted will be the best marketing tool.

61/150 CONCLUSION

.01 Although the situation of each financially troubled company is unique, the general approach for providing consulting services probably will be the same for all. The engagement approach requires a team effort by legal counsel, management, and the practitioner, the latter providing an independent, objective analysis. Although difficult, this type of engagement can be very rewarding because it allows the experienced practitioner to use many skills acquired during years of practice.

APPENDIX 61/A

STATEMENT ON STANDARDS FOR CONSULTING SERVICES

CONSULTING SERVICES: DEFINITIONS AND STANDARDS

Introduction

1. Consulting services that CPAs provide to their clients have evolved from advice on accounting-related matters to a wide range of services involving diverse technical disciplines, industry knowledge, and consulting skills. Most practitioners, including those who provide audit and tax services, also provide business and management consulting services to their clients.

2. Consulting services differ fundamentally from the CPA's function of attesting to the assertions of other parties. In an attest service, the practitioner expresses a conclusion about the reliability of a written assertion that is the responsibility of another party, the asserter. In a consulting service, the practitioner develops the findings, conclusions, and recommendations presented. The nature and scope of work is determined solely by the agreement between the practitioner and the client. Generally, the work is performed only for the use and benefit of the client.

3. Historically, CPA consulting services have been commonly referred to as management consulting services, management advisory services, business advisory services, or management services. A series of Statements on Standards for Management Advisory Services (SSMASs) previously issued by the AICPA contained guidance on certain types of consulting services provided by members. This Statement on Standards for Consulting Services (SSCS) supersedes the SSMASs and provides standards of practice for a broader range of professional services, as described in paragraph 5.

4. This SSCS and any subsequent SSCSs apply to any AICPA member holding out as a CPA while providing Consulting Services as defined herein.

Definitions

5. Terms established for the purpose of the SSCSs are as follows:

Consulting Services Practitioner. Any AICPA member holding out as a CPA while engaged in the performance of a Consulting Service for a client, or any other individual who is carrying out a consulting service for a client on behalf of any Institute member or member's firm holding out as a CPA.

Consulting Process. The analytical approach and process applied in a Consulting Service. It typically involves some combination of activities relating to determination of client objectives, fact-finding, definition of the problems or opportunities, evaluation of alternatives, formulation of proposed action, communication of results, implementation, and follow-up.

Consulting Services. Professional services that employ the practitioner's technical skills, education, observations, experiences, and knowledge of the consulting process.[1] Consulting Services may include one or more of the following:

a. Consultations, in which the practitioner's function is to provide counsel in a short time frame, based mostly, if not entirely, on existing personal knowledge about the client, the circumstances, the technical matters involved, client representations, and the mutual intent of the parties. Examples of consultations are reviewing and commenting on a client-prepared business plan and suggesting computer software for further client investigation.

b. Advisory services, in which the practitioner's function is to develop findings, conclusions, and recommendations for client consideration and decision making. Examples of advisory services are an operational review and improvement study, analysis of an accounting system, assistance with strategic planning, and definition of requirements for an information system.

c. Implementation services, in which the practitioner's function is to put an action plan into effect. Client personnel and resources may be pooled with the practitioner's to accomplish the implementation objectives. The practitioner is responsible to the client for the conduct and management of engagement activities. Examples of implementation services are providing computer system installation and support, executing steps to improve productivity, and assisting with the merger of organizations.

d. Transaction services, in which the practitioner's function is to provide services related to a specific client transaction, generally with a third party. Examples of transaction services are insolvency services, valuation services, preparation of information for obtaining financing, analysis of a potential merger or acquisition, and litigation services.

e. Staff and other support services, in which the practitioner's function is to provide appropriate staff and possibly other support to perform tasks specified by the client. The staff provided will be directed by the client as circumstances require. Examples of staff and other support services are data processing facilities management, computer programming, bankruptcy trusteeship, and controllership activities.

f. Product services, in which the practitioner's function is to provide the client with a product and associated professional services in support of the installation, use, or maintenance of the product. Examples of product services are the sale and delivery of packaged training programs, the sale and implementation of computer software, and the sale and installation of systems development methodologies.

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[1] The definition of Consulting Services excludes the following:

a. Services subject to other AICPA Technical Standards such as Statements on Auditing Standards (SASs), Statements on Standards for Attestation Engagements (SSAEs), or Statements on Standards for Accounting and Review Services (SSARSs). (These excluded services may be performed in conjunction with Consulting Services, but only the Consulting Services are subject to the SSCS.)

b. Engagements specifically to perform tax return preparation, tax planning/advice, tax representation, personal financial planning or bookkeeping services; or situations involving the preparation of written reports or the provision of oral advice on the application of accounting principles to specified transactions or events, either completed or proposed, and the reporting thereof.

c. Recommendations and comments prepared during the same engagement as a direct result of observations made while performing the excluded services.

Standards for Consulting Services

6. The general standards of the profession are contained in rule 201 of the AICPA Code of Professional Conduct (AICPA, *Professional Standards*, vol. 2, ET sec. 201.01) and apply to all services performed by members. They are as follows:

Professional competence. Undertake only those professional services that the member or the member's firm can reasonably expect to be completed with professional competence.

Due professional care. Exercise due professional care in the performance of professional services.

Planning and supervision. Adequately plan and supervise the performance of professional services.

Sufficient relevant data. Obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed.

7. The following additional general standards for all Consulting Services are promulgated to address the distinctive nature of Consulting Services in which the understanding with the client may establish valid limitations on the practitioner's performance of services. These Standards are established under rule 202 of the AICPA Code of Professional Conduct (AICPA, *Professional Standards*, vol. 2, ET sec. 202.01).

Client interest. Serve the client interest by seeking to accomplish the objectives established by the understanding with the client while maintaining integrity and objectivity.[2]

Understanding with client. Establish with the client a written or oral understanding about the responsibilities of the parties and the nature, scope, and limitations of services to be performed, and modify the understanding if circumstances require a significant change during the engagement.

Communication with client. Inform the client of (*a*) conflicts of interest that may occur pursuant to interpretations of rule 102 of the Code of Professional Conduct,[3] (*b*) significant reservations concerning the scope or benefits of the engagement, and (*c*) significant engagement findings or events.

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[2] Article III of the Code of Professional Conduct describes *integrity* as follows:

> "Integrity requires a member to be, among other things, honest and candid within the constraints of client confidentiality. Service and the public trust should not be subordinated to personal gain and advantage. Integrity can accommodate the inadvertent error and the honest difference of opinion; it cannot accommodate deceit or subordination of principle."

Article IV of the Code of Professional Conduct differentiates between *objectivity* and *independence* as follows:

> "Objectivity is a state of mind, a quality that lends value to a member's services. It is a distinguishing feature of the profession. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest. Independence precludes relationships that may appear to impair a member's objectivity in rendering attestation services."

[3] Rule 102-2 on Conflicts of Interest states, in part, the following:

> "A conflict of interest may occur if a member performs a professional service for a client or employer and the member or his or her firm has a significant relationship with another person, entity, product, or service that could be viewed as impairing the member's objectivity. If this significant relationship is disclosed to and consent is obtained from such client, employer, or other appropriate parties, the rule shall not operate to prohibit the performance of the professional service . . . ."

8. Professional judgment must be used in applying Statements on Standards for Consulting Services in a specific instance since the oral or written understanding with the client may establish constraints within which services are to be provided. For example, the understanding with the client may limit the practitioner's effort with regard to gathering relevant data. The practitioner is not required to decline or withdraw from a consulting engagement when the agreed-upon scope of services includes such limitations.

Consulting Services for Attest Clients

9. The performance of Consulting Services for an attest client does not, in and of itself, impair independence.[4] However, members and their firms performing attest services for a client should comply with applicable independence standards, rules and regulations issued by the AICPA, the state boards of accountancy, state CPA societies, and other regulatory agencies.

Effective Date

10. This Statement is effective for engagements accepted on or after January 1, 1992. Early application of the provisions of this Statement is permissible.

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[4] AICPA independence standards relate only to the performance of attestation services; objectivity standards apply to all services. See footnote 2.

APPENDIX 61/B

SAMPLE FORMS AND CHECKLISTS

Exhibit 61B-1

Engagement Acceptance Checklist—CPA Firm Considerations

	Yes	No
1. Will the engagement create conflict-of-interest or independence problems?	______	______
2. Will the engagement affect errors and omissions insurance for—		
a) Availability?	______	______
b) Cost?	______	______
c) Coverage?	______	______
3. Do we have adequate knowledge of—		
a) The industry?	______	______
b) Bankruptcy rules and procedures?	______	______
4. Do we have adequately trained staff to meet the engagement objectives?	______	______
5. Is the engagement consistent with our firm's goals and policies?	______	______
6. Will the engagement adversely affect the firm professionally?	______	______

Exhibit 61B-2

Engagement Acceptance Checklist—Client Considerations

	Yes	No
1. Have we contacted the client's prior accountant?	______	______
2. Has the company been bankrupt before?	______	______
If so, when? ________________________________		
3. Are the owners-managers capable of dealing with the situation and carrying out the plan?	______	______
4. Are company records up to date and reliable?	______	______
5. Will company managers cooperate in carrying out suggestions?	______	______
6. Is the company current on all state and federal income and employment taxes and on all sales taxes?	______	______
7. Does the industry have a history of illegal practices?	______	______
8. Are the owners and managers of high integrity and honesty?	______	______
9. Does the company have the ability to pay the accounting and consulting fees?	______	______

Exhibit 61B-3

Permanent Information Form

Client

Name ______________________
Address ______________________
____

Contact ______________________
Phone(s) ______________________

Troubled Business (if different)

Name ______________________
Address ______________________
____

Contact ______________________
Phone(s) ______________________

Prior accountant ______________________
Attorney(s) (including bankruptcy specialists) ______________________
____

Banking relationships ______________________
____

Principals (Stockholders)

______ Profile # ______
______ Profile # ______
______ Profile # ______
______ Profile # ______
______ Profile # ______
______ Profile # ______

Managers (if different)

______ Profile # ______
______ Profile # ______
______ Profile # ______
______ Profile # ______
______ Profile # ______
______ Profile # ______

Prior financial information (attach statements and original chart)

Years ______ ______ ______ ______ ______ ______ ______ ______

Number of locations, plants, etc. (attach square footage and location)

____
____

Obtain copies of union agreements and pension and profit plans ______________________

Disposition of reports/correspondence

Distribution ______________________
____
____

Number of copies ______________________
____
____

Fee arrangements ______________________
____

Exhibit 61B-4

Company Profile

Name ______________________________

Major creditors/suppliers

Company	*Amount Due* Total	Disputed	*Comments*

Major customers

Company	*Account Balance*	*Comments*

Existing and pending litigation

____
____
____

Union relationship

____
____
____

Industry standards	Comments/analysis (key ratios, illegal acts, etc.)

Exhibit 61B-5

Key Personnel Profile
(Managers/Principals)

Name ____

Length of service ______________________________________

Relevant experience ____________________________________

Function or title ______________________________________

Reporting relationships (direct/indirect) ____________________

Evaluation

Strengths ____

____

Weaknesses ____

____

Assessment of capacity for change

Original ideas offered ________________________________

Acceptance of ideas __________________________________

Personal characteristics (integrity, sincerity) ________________

____

Comments and summary _________________________________

____

____

Exhibit 61B-6

Engagement Administration Checklist

Engagement Acceptance	*Date Completed*
1. Permanent information form	____________
2. Engagement acceptance checklist of CPA firm considerations	____________
3. Engagement acceptance checklist of client considerations	____________
4. Budget and engagement objectives	____________
5. Engagement letter returned and signed	____________

Engagement Performance

	Person Responsible			Date	Date
Activity	Client	Attorney	CPA	Due	Completed

APPENDIX 61/C

CASE STUDY: ASSISTING FINANCIALLY TROUBLED FINE FAMILY FOODS, INC.

Fine Family Foods, Inc. is a single-site family restaurant and lounge with annual sales of approximately $1 million. The company is experiencing financial difficulties due to increased competition, a deteriorating building, and an expensive, but unsuccessful, attempt to automate its operations.

The company is on cash-and-carry terms with all of its suppliers, and several creditors are threatening legal action. The building and grounds require major improvements to meet health standards. The company's lease makes it responsible for such improvements. The landlord is bringing legal action to collect back rent, and the company that leased the defunct computer is suing for payment for equipment and software.

Tom Jones, the owner-manager of Fine Family Foods, Inc., contacted his CPA, William Smith, for assistance in resolving the financial problems. Smith's familiarity with the business and his experience with similar situations permits him to accept the engagement. He later forwards an engagement letter to Mr. Jones (exhibit 61C-1). Smith also advises Jones to seek the counsel of an attorney specializing in financially troubled businesses. He provides Jones with a list of attorneys with whom he has worked before.

Smith meets with the client and the attorney to gather information about the legal contingencies and remedies. After discussions with Jones, he agrees to compile a current comparative financial statement and cash flow forecasts of future operations. Additionally, he agrees to prepare a written report (exhibit 61C-2) of recommendations about the current status of the business and alternative actions for the future. He also agrees to prepare a balance sheet adjusted to liquidation values, which will be used for negotiating with unsecured creditors.

Exhibit 61C-1

Engagement Letter

William Smith and Associates
10 South Street
Anytown, USA 12345

January 4, 19XY

Mr. Thomas Jones
Fine Family Foods, Inc.
1 Main St.
Anytown, USA 12345

Dear Mr. Jones:

This letter will confirm the terms of our engagement to provide consulting services and our understanding of the nature of those services.

The objectives of the engagement are to—

- Assist you in gathering the information necessary to make decisions about the feasibility of continuing the operations of your company.

- Provide you with a report detailing our analysis of and recommendations about your financial situation.

- Assist in preparing a plan for reorganization, including appropriate financial information.

To meet the above engagement objectives, we will need the assistance of your staff. We will rely on them to provide us with current and historical financial statements, organization charts, and information about financial projections, cash flow, marketing, staffing, comparative industry statistics, and other information as required.

At the conclusion of the engagement, we will prepare a report of our findings and recommendations regarding the viability of your business. We will submit the report to you by January 31, 19XY.

Our fee for this engagement will be $X,000, to be paid as follows: a retainer of $X,000 in advance of the start of the engagement; an additional retainer will be due as each prior retainer is used.

Either party reserves the right to terminate this engagement upon presentation of written notice.

If this letter correctly expresses your understanding, please indicate by signing the enclosed copy of the letter and returning it with a retainer of $X,000 as authorization to proceed with the engagement.

Sincerely,

William Smith, CPA

Accepted by ____________________
Title ________________________

Date ________________________

Exhibit 61C-2

Final Report

William Smith and Associates
10 South Street
Anytown, USA 12345

January 31, 19XY

Mr. Thomas Jones
Fine Family Foods, Inc.
1 Main St.
Anytown, USA 12345

Dear Mr. Jones:

We have completed the analysis of the financial situation of your company. Current and forecasted financial statements as of December 31, 19XX, compiled by us, are attached with appropriate reports. We have also compiled the information in the report entitled "Balance Sheet and Adjustments to Liquidation Values," which is also attached.

Company Description

The company is a closely held single-site family restaurant and lounge with annual sales of nearly $1 million. The restaurant and building have been at the rural site for forty-five years. For many years, the company was the only full-service restaurant in the area.

Financial Situation

The current financial situation, indicated by the attached financial statements, is as follows:

1. Fine Family Foods, Inc's., current liabilities exceed current assets by $60,347.

2. The company is in default on a lease of computer equipment of $33,341, which is all due currently.

3. The company has a year-to-date loss of $5,766 after the gain on sale of restaurant equipment of $7,890. The last two years have been about break-even. Previously, the company had steady profits of about 6 percent of sales, consistent with industry standards for a restaurant of its size.

Reasons for Current Financial Position

The company's current financial distress is due to the following causes:

1. The company's building is deteriorating badly, and consequently, patronage is eroding. The company is in dispute with the landlord over needed improvements.

2. New competition is also eroding patronage.

3. The company was unable to install an automated cash register system, and the leasing company is threatening action to collect on default of the agreement.

4. Labor and food costs have risen above industry norms. The rise in food costs is due to the lack of timely revisions in menu pricing and to suppliers' placing the company on a higher pricing schedule because of slow payment.

5. Owners' salaries and entertainment costs are above the industry norms.

6. Fortunately, payroll and related labor costs have been kept below those of comparable sized restaurants.

Options Available for the Short Term

We recommend that Fine Family Foods, Inc., take the following actions immediately:

1. Negotiate with the landlord to renovate the building and possibly finance the renovation through increased rent.

2. Pursue legal remedies to deal with the leasing company regarding the cash registers.

3. Reprice menus and negotiate with suppliers for better terms. Give notes on old balances as a means of showing good faith.

4. Reduce officers' compensation and entertainment costs to reflect the current situation and industry norms.

Long-Term Recommendations

These short-term recommendations address only immediate problems. We believe a comprehensive long-term solution will require a formal approach to business planning. We would be pleased to assist you in preparing a long-range strategic plan.

Sincerely,

William Smith, CPA

Attachments

Attachment A

Fine Family Foods, Inc.
Statistical Controls Analysis (Ratio to Total Sales)

	Your Restaurant			*Median-Restaurants of*
	19X0	*19XX*	*U. S. Median*	*Similar Size*
Sales per square foot	$ 165	$ 166	N/A	$187
Sales per full-time equivalent employee	$39,760	$39,971	$37,959	N/A
Combined merchandise cost	35.00%	37.00%	34.50%	32.20%
Payroll and related labor cost	33.00%	33.00%	31.60%	39.90%
Combined payroll and merchandise cost	68.00%	70.00%	66.10%	72.10%
Advertising	1.10%	1.20%	1.90%	1.20%
Entertainment	3.00%	3.10%	.30%	.10%
Promotion (see advertising)	—	—	—	—
Depreciation	1.10%	1.10%	2.70%	3.00%
Rent, property taxes, and insurance (occupancy)	8.60%	9.00%	7.70%	6.80%
Utilities	3.00%	2.90%	3.20%	4.30%
Net income (loss) (before gain on equipment)	.05%	-1.40%	4.40%	2.60%

Sources: Laventhol & Horwath; William Smith, CPA

Attachment B

Fine Family Foods, Inc.
Key Financial Ratio Analysis

	19X0	19XX
Current ratio	.26	.35
Working capital	$-71,347	$-80,374
Gross profit	64.80%	62.70%
Net income (loss)	.05%	-.57%*
Debt to equity	6.70	10.00

* -1.40% after excluding gain on sale of equipment

Attachment C

Fine Family Foods, Inc.
Information Summary

	19X0	19XX
Number of seats	125	125
Square footage	6,024	6,024
Number of employees (FTE)	25	25

Exhibit 61C-2.1

Fine Family Foods, Inc.—Current Financial Information

William Smith and Associates
10 South Street
Anytown, USA 12345

January 31, 19XY

Mr. Thomas Jones
Fine Family Foods, Inc.
1 Main Street
Anytown, USA 12345

Dear Mr. Jones:

The accompanying balance sheets of Fine Family Foods, Inc., as of December 31, 19XO and 19XX, and the related statement of operations for the years then ended, have been compiled in accordance with standards established by the American Institute of Certified Public Accountants.

A compilation is limited to presenting, in the form of financial statements, information that is the representation of management. I have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

Management has elected to omit substantially all of the disclosures required by generally accepted accounting principles. If the omitted disclosures were included with the financial statements, they might influence the user's conclusions about the company's financial position. Accordingly, these financial statements are not designed for those who are not informed about such matters.

The accompanying financial statements have been prepared assuming that the company will continue as a going concern. The company's ability to continue is dependent upon successful negotiations with the company's creditors and lessor. This contingency raises substantial doubt about its ability to continue operations.

Sincerely,

William Smith, CPA

Fine Family Foods, Inc.
Balance Sheet
(See Accountant's Compilation Report)

Assets	December 31, 19X0	December 31, 19XX
Current assets		
Cash	$ 78	$ 7,968
Accounts receivable	6,291	6,325
Inventories	16,519	16,607
Prepaid expenses	2,200	2,215
Total current assets	25,088	33,115
Property and equipment	116,997	106,997
Less accumulated depreciation	80,897	88,603
Net property and equipment	36,100	18,394
Other assets		
Contract receivables—noncurrent	13,392	13,392
Goodwill—net	48,620	47,787
Total other assets	62,012	61,179
Total assets	$123,200	$112,688
Liabilities and Shareholder's Equity		
Current liabilities		
Trade accounts payable	$ 17,440	$ 17,767
Capital lease payable, current	33,341	33,341
Withholdings	6,050	6,504
Unemployment taxes payable	7,484	7,284
Industrial insurance payable	7,670	6,031
Sales tax payable	9,050	9,127
Accrued salaries	13,500	13,350
Other current liabilities	1,900	85
Total current liabilities	96,435	93,489
Capital lease, less current portion	10,807	9,007
Total liabilities	107,242	102,496
Common stock, 50,000 shares authorized; 50,000 shares issued and outstanding	$ 50,000	$ 50,000
Retained earnings	(9,547)	(9,042)
Current period income (loss)	505	(5,766)
Treasury stock—at cost (25,000 shares)	(25,000)	(25,000)
Total equity	15,958	10,192
Total liabilities and equity	$123,200	$112,688

Fine Family Foods, Inc.
Statement of Operations
Years Ended December 31,
(See Accountant's Compilation Report)

	19X0	19XX
Sales	$994,018	$999,276
Cost of sales	349,799	372,796
Gross profit	644,219	626,480
Expenses		
Wages	270,301	273,395
Payroll taxes	54,220	54,825
Employee benefits	3,300	3,350
Depreciation	11,101	10,596
Operating supplies	38,288	40,172
Utilities	29,372	29,452
Laundry	5,400	5,638
Repairs and maintenance	18,184	18,983
Advertising and promotion	11,470	11,975
Entertainment	29,399	30,691
Transportation	5,671	5,921
Administration	54,494	56,888
B & O tax	6,666	6,959
Occupancy costs	85,845	89,617
Other	1,603	1,674
Total	625,314	640,136
Operating income (loss)	18,905	(13,656)
Other income—sale of restaurant equipment	---	7,890
Net income (loss) before taxes	505	(5,766)
Income taxes	---	---
Net income (loss)	$ 19,410	($ 5,766)

Exhibit 61C-2.2

Fine Family Foods, Inc.
Balance Sheet and Adjustment to Liquidation Values

William Smith and Associates
10 South Street
Anytown, USA 12345

January 31, 19XY

Mr. Thomas Jones
Fine Family Foods, Inc.
1 Main Street
Anytown, USA 12345

Dear Mr. Jones:

I have compiled the accompanying balance sheet and adjustments to liquidation values for Fine Family Foods, Inc., as of December 31, 19XX, in accordance with standards established by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (the owners). I have not audited or reviewed the accompanying balance sheet and, accordingly, do not express an opinion or any other form of assurance on it.

Management (the owners) have elected to omit substantially all of the disclosures required by generally accepted accounting principles. If the omitted disclosures were included with the balance sheet, they might influence the user's conclusions about the company's financial position. Accordingly, this balance sheet is not designed for those who are uninformed about such matters.

Sincerely,

William Smith, CPA

Fine Family Foods, Inc.
Balance Sheet and Adjustments to Liquidation Values
December 31, 19XY
(See Accountant's Compilation Report)

	Book Value	*Adjustments*	*Liquidation Value*	*Secured & Priority*	
Assets					
Current assets					
Cash *a*	$ 7,968		$ 7,968		
Accounts receivable *b*	6,325	(6,325)	0		
Inventories *c*	16,607	(3,321)	13,286		
Prepaid expenses *b*	2,215	(2,215)	0		
Property and equipment *d*	106,997	(82,227)	24,770		
Less accumulated depreciation *b*	(88,603)	88,603	0		
Other assets					
Contract receivable *e*	13,392	(2,678)	10,714		
Goodwill—net *b*	47,787	(47,787)	0		
	$112,688		$ 56,738	$56,738	
Liabilities					
Current liabilities					
Trade accounts payable *f*	$ 17,767		$ 17,767		
Taxes payable *g*	28,946		28,946	28,946	first
Withholdings *h*	13,350		13,350	13,350	first
Other current liabilities *i*	85		85	85	first
Long-term debt *j*	42,348		42,348	9,007	secured
Net equity *b*	10,192		10,192		
Totals	$112,688		$112,688		
Cost of Liquidation 15% of assets liquidated				8,511	
Available (short) for unsecured				($ 3,162)	

---

a Cash liquidation at face value
b No liquidation value
c Inventories discounted for restocking of 20%
d Fixed assets appraised at approximately 30% of cost
e Private contract discounted 20% for forced sale
f Unsecured no priority
g Taxes payable—first priority
h Withholdings—first priority
i Garnishment—first priority
j Contract secured by contract receivable; lease payable property returned

Exhibit 61C-2.3

Fine Family Foods, Inc.
Forecasted Financial Statements

William Smith and Associates
10 South Street
Anytown, USA 12345

January 31, 19XY

Mr. Thomas Jones
Fine Family Foods, Inc.
1 Main Street
Anytown, USA 12345

We have compiled the accompanying forecasted balance sheet and income statement and supplemental income information of Fine Family Foods, Inc., for the twelve months ending December 31, 19XY, in accordance with standards established by the American Institute of Certified Public Accountants.

The accompanying forecast and this report were prepared for the Plan of Reorganization filed before the United States Bankruptcy Court for the aforementioned corporation and should not be relied on for any other purpose.

A compilation is limited to presenting, in the form of a forecast, information that is the representation of management and does not include evaluation of the support for the assumptions underlying the forecast. We have not examined the forecasts and, accordingly, do not express an opinion or any other form of assurance on the accompanying statements or assumptions. Furthermore, if the forecasted sales are realized, the actual results will probably differ from the forecasts and the difference may be material. We have no responsibility to update this report to account for events and circumstances occurring after the date of the report.

Sincerely,

William Smith, CPA

Fine Family Foods, Inc.
Forecasted Balance Sheet
December 31, 19XY
(See Accountant's Compilation Report)

Assets	
Current assets	
Cash	$ 21,140
Accounts receivable	7,500
Inventories	15,400
Prepaid expenses	2,000
Total current assets	46,040
Property and equipment	122,600
Less accumulated depreciation	95,800
Net property and equipment	26,800
Other assets	
Contract receivable—noncurrent	12,500
Goodwill—net	46,500
Total other assets	59,000
Total assets	$131,840
Liabilities and Shareholder's Equity	
Current liabilities	
Trade accounts payable	$ 5,200
Capital lease payable, current	33,000
Withholdings	4,500
Unemployment taxes payable	5,000
Industrial insurance payable	3,000
Sales tax payable	4,000
Accrued salaries	13,000
Other current liabilities	2,278
Total current liabilities	69,978
Capital leases, less current portion	23,500
Total liabilities	$ 93,478
Common stock, 50,000 shares authorized; 50,000 shares issued and outstanding	$ 50,000
Retained earnings	(14,808)
Current period income	28,170
Treasury stock—at cost (25,000 shares)	(25,000)
Total equity	38,362
Total liabilities and equity	$131,840

Fine Family Foods, Inc.
Forecasted Income Statement
and Cash Flows from Operations
For the Twelve Months Ending December 31, 19XY
(See Accountant's Compilation Report)

	Total	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Sales	$ 751,600	$48,400	$46,600	$56,100	$57,000	$64,300	$66,200	$85,700	$87,300	$74,000	$77,400	$43,000	$45,600
Cost of Sales	264,300	17,000	16,400	19,800	20,100	22,600	23,300	30,100	30,700	26,000	27,200	15,100	16,000
Gross Profit	487,300	31,400	30,200	36,300	36,900	41,700	42,900	55,600	56,600	48,000	50,200	27,900	29,600
Expenses													
Wages	192,100	12,300	11,900	14,300	14,600	16,400	16,900	21,800	22,700	18,900	19,700	11,000	11,600
Payroll taxes	38,900	2,500	2,400	2,900	3,000	3,300	3,400	4,500	4,500	3,800	4,000	2,200	2,400
Employee benefits	1,400	100	100	100	100	100	100	200	200	100	100	100	100
Depreciation	7,200	600	600	600	600	600	600	600	600	600	600	600	600
Operating supplies	24,800	1,600	1,500	1,900	1,900	2,100	2,200	2,800	2,900	2,400	2,600	1,400	1,500
Utilities	28,800	2,400	2,400	2,400	2,400	2,400	2,400	2,400	2,400	2,400	2,400	2,400	2,400
Laundry	6,900	500	400	500	500	600	600	800	800	700	700	400	400
Repairs and maintenance	14,400	900	900	1,100	1,100	1,200	1,300	1,600	1,700	1,400	1,500	800	900
Advertising and promotion	15,900	1,000	1,000	1,200	1,200	1,300	1,400	1,800	1,900	1,500	1,700	900	1,000
Entertainment	7,800	500	500	600	600	600	700	900	900	800	800	400	500
Transportation	4,800	400	400	400	400	400	400	400	400	400	400	400	400
Administration	16,800	1,400	1,400	1,400	1,400	1,400	1,400	1,400	1,400	1,400	1,400	1,400	1,400
B & O tax	3,130	200	190	230	240	270	280	360	360	310	320	180	190
Occupancy costs	60,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000
	1,200	100	100	100	100	100	100	100	100	100	100	100	100
Total	424,130	29,500	28,790	32,730	33,140	35,770	36,780	44,660	45,860	39,810	41,320	27,280	28,490
Operating income	63,170	1,900	1,410	3,570	3,760	5,930	6,120	10,940	10,740	8,190	8,880	620	1,110
Officers' salary	30,000	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500
Net income before tax	33,170	(600)	(1,090)	1,070	1,260	3,430	3,620	8,440	8,240	5,690	6,380	(1,880)	(1,390)
Income tax	5,000												5,000
Net income	28,170	(600)	(1,090)	1,070	1,260	3,430	3,620	8,440	8,240	5,690	6,380	(1,880)	(6,390)
Cumulative		(600)	(1,690)	(620)	640	4,070	7,690	16,130	24,370	30,060	36,440	34,560	28,170

Adjustments to cash													
Depreciation	7,200	600	600	600	600	600	600	600	600	600	600	600	600
Capital improvements	(15,600)	(1,300)	(1,300)	(1,300)	(1,300)	(1,300)	(1,300)	(1,300)	(1,300)	(1,300)	(1,300)	(1,300)	(1,300)
Principal on debt	(6,600)	(550)	(550)	(550)	(550)	(550)	(550)	(550)	(550)	(550)	(550)	(550)	(550)
Cash from operations incl. (Dec.)	13,170	(1,850)	(2,340)	(180)	10	2,180	2,370	7,190	6,990	4,440	5,130	(3,130)	(7,640)
Beginning cash	$ 7,970												
Cumulative		$ 6,120	$ 3,780	$ 3,600	$ 3,610	$ 5,790	$ 8,160	$ 15,350	$ 22,340	$ 26,780	$ 31,910	$ 28,780	$ 21,140

See the accompanying summaries of significant forecast assumptions and accounting policies.

Notes to Forecasted Income Statement
December 31, 19XY
(See Accountants' Compilation Report)

Note 1 — Nature of Forecast

This financial forecast is management's estimate of the results of operations and significant changes in financial position for the forecast period assuming a certain level of forecasted sales is attained. Accordingly, the financial forecast reflects the assumptions that management believes are significant to the forecast as well as management's judgment of the conditions, based on present circumstances, and its course of action if the estimated sales levels are attained. However, even if these sales materialize, unexpected events and circumstances may cause material differences between the forecast and actual results. The forecast was prepared for the Plan of Reorganization filed before the United States Bankruptcy Court for the corporation described below.

Fine Family Foods, Inc., is a single-site family restaurant and cocktail lounge.

Note 2 — Revenue

Management has forecasted the expected sales based on the prior year's sales in the same month, except for November and December, which were based on 19XX months. Consideration has been given to the capacity of existing facilities. Sales are expected to decrease by approximately 25 percent due to competition.

Note 3 — Operating Expenses

Operating expenses and overhead were determined by management based on the company's prior year's expenses adjusted for known differences.

Note 4 — Provision for Extraordinary Maintenance

The company will require $1,250 per month for additional operating and capital expenditures to maintain adequate health standards.

Note 5 — Assumptions

The following assumptions were used in producing this forecast.

Variables

Cost of sales is forecast at 35 percent of gross sales.

November and December sales are based on the prior year's sales.

Expenses — As a Percentage of Gross Sales (except as Noted)

Wages	25.56%
Payroll taxes	5.20%
Employee benefits	0.20%
Depreciation	$ 600 per month
Operating supplies	3.30%
Utilities	$2,400 per month
Other direct operating	1.00%
Repairs and maintenance	2.00%
Advertising and promotion	2.00%
Entertainment	1.00%
Transportation	$ 400 per month
Administration	$1,400 per month
B & O tax	0.44%
Occupancy costs	$5,000
Other	0.10%

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